



MEMORANDUM
OFFICE OF THE
COUNTY EXECUTIVE
COUNTY OF PLACER

TO: Honorable Board of Supervisors

FROM: Thomas M. Miller, County Executive Officer
By Graham Knaus, Finance and Budget Operations Manager

DATE: February 22, 2011

SUBJECT: FY 2011-12 Strategic Budget and Policy Briefing

Action Requested

Accept an update on the County Budget and Financial Status and identify areas of focus for the FY 2011-12 Budget.

Background

Since the Fall of 2007, the Federal, State, and Local economies have been entrenched in the most difficult recession since the Great Depression. Local resources to meet obligations have declined, straining the County Budget while service demands in some areas have increased.

As a result of your Board's continued current and long-term planning efforts, the County is relatively well positioned to continue to weather the economic storm in this downturn economy. Additional challenges certainly lie ahead; however, most are primarily a function of Federal and/or State actions. Local challenges can be met through the Board's continued pro-active and measured course to best meet the needs of residents within our locally available resources.

Changing County Landscape

Population Growth

Placer County has been one of the fastest growing counties in the State for a number of years in large part driven by the comparatively strong economy, spectacular and diverse landscape, and population exodus from more urban centers such as Sacramento, Southern California, and the Bay Area. As a result of these unique factors, Placer County has been the fastest growing county in the State over the past decade growing from 248,399 to 347,102 residents. This population growth reflects a 28 percent increase in County residents compared to the statewide population growth of 12 percent.

Although there has been significant population growth throughout the County, it has largely been focused in Western/Southern portion of the County and in existing incorporated areas. Of the total 98,703 new residents over the past decade, 88 percent of the growth has occurred within existing city boundaries.

The pace of County population growth, however, has tapered off significantly, decreasing from an annual growth of five percent at the beginning of the decade to 1.5 percent last year.

Increasing Service Needs

County service needs and revenues have historically been driven by population, economic factors, and State actions. The community service needs, comprising Federal and State mandated functions as well as locally driven priorities, have grown dramatically over the past 10 years along with the population. Growth in service needs has spanned the breadth of County services; however, the primary growth has occurred in countywide responsibilities that are not a function of our local City partners. Specific growth areas include Public Safety and Health and Human Services where demands are driven by population growth and State law changes.

Increasing countywide service demands to meet Federal, State, and local obligations and expectations requires revenues to grow at a similar pace. An increasing challenge for the County is that the service demands are largely provided in cities where the population growth has occurred but are funded by per capita revenues much lower than in the unincorporated areas. For example, the incorporated areas of the county average \$135 per capita in property tax compared to \$252 per capita property tax countywide.

Economic Rise and Fall

Historically, revenues lead expenditures. During periods of strong economic growth, this results in providing annual and multi-year flexibility to the Board as revenue growth in the County outpaces expenditure growth. However, revenue growth stagnated in FY 2007-08, followed by the most rapid decline in revenues since 1978.

Boom to Bust

During the early to mid 2000s, the Federal, State, and local economies were growing at a rapid pace. Unemployment, often used as a yardstick for the level of economic growth or decline, was at or near all-time lows. Specifically, in December 2000 unemployment was four percent nationally, 4.9 percent in California, and 3.1 percent in Placer County. As the housing and financial markets collapsed, unemployment grew quickly and has steadied at 9.6 percent nationally, 12.5 percent in California, and 11.5 percent in Placer County, the highest level on record. In addition, there are many workers that remain employed but at levels substantially below where they had been just a few years ago.

The boom years were characterized by highly accessible credit markets and accelerated land wealth driving property tax revenues up. As the markets contracted, commercial, residential, and retail credit became highly in-accessible resulting in sharply declining economic activity and housing values.

In short, the economy rose and fell rapidly and appears to be in the final stages of re-basing itself to a more sustainable level. It may take another year or two of stagnation/decline prior to completely settling down.

Prior Board Actions

Budget and Financial Policy

The Budget and Financial Policy was initially approved by the Board in 2003 and is intended to guide the budget and long-term financial planning related to preparation and management of the County budget. The policy has been an integral component to creating a successful County framework to respond to the economic downturn. The policy provides a broader context of budget and financial planning to appropriately position County staff to work within parameters set by the Board and to ensure a fiscally sound short-term and long-term approach to the Budget. The Budget and Financial Policy includes the following guiding principles:

- The annual Budget shall recognize the short-term and long-term revenue and expenditure trends and plan for opportunities and risks.
- One-time revenues should be used for one-time costs.
- The annual Budget shall be based on a generally conservative approach to allow for greater Board flexibility and smoothing during periods of economic growth or decline.

Debt Management Policy

The Debt Management Policy was initial approved by the Board in 2003 and is intended to serve as a tool to manage the County's approach to debt issuance.

The Debt Management Policy includes the following guiding principles:

- The County shall maintain a sustainable balance of debt and equity to meet long-term capital needs.
- Debt issuance should focus on high priority capital projects, those that are self-supporting through increased revenues or decrease County costs, or to create generational equity in spreading costs between current taxpayers and service users and future taxpayers and service users.
- The County shall use a pay-as-you-go approach whenever feasible to avoid deferring current obligations or creating an undue financial burden on future Boards.

OPEB Policy

The Other Post Employment Benefit (OPEB) Policy was initially approved by the Board in 2006 and was updated at the September 7, 2010 Board meeting. The OPEB Policy is intended to provide a structural roadmap to fund the County's obligations for retirees.

The OPEB Policy requires:

- Transfer all OPEB related assets and funding to a trust to set-aside funds to meet the County's obligation as well as maximize investment returns to reduce the obligation.
- Funding the Annual Required Contribution (ARC) to the greatest degree possible based on the most recent actuarial.

The September 2010 revision to the OPEB Policy requires advanced OPEB funding for new hires. The Policy directs the set-aside of 50 percent of the estimated liability per new employee. Doing so will result in further containing the County's OPEB obligation over time.

Strategic Board Actions

As the economic rise began to approach the cliff in 2007, the Board began to take a number of actions to bridge the transition to a period of unstable and declining revenues. Actions in the last three years have included:

December 2007 – Implemented hiring freeze that has resulted in 320 fewer filled positions from FY 2007-08 to FY 2010-11.

December 2008 – Implemented four days of mandatory time off and office closures, approved use of reserves, as well as other measures to address a \$9.5 million mid-year revenue decline.

September 2009 – Adopted a FY 2009-10 Final Budget addressing an \$18 million deficit. The Final Budget was 9.4 percent lower than the prior year and included \$6.5 million in savings due to 12 days of mandatory time off and office closures in addition to approved use of \$4 million in reserves.

September 2010 – Adopted a FY 2010-11 Final Budget addressing a \$23.6 million deficit. The Final Budget was 3.3 percent lower than the prior year and included increased employee pension and health care cost sharing, approved use of reserves, prioritizing resources to fund core direct services, and five days of mandatory time off and office closures.

In addition, the Board directed the creation of the Cost Savings Task Force to develop recommended changes to business practices. The recommendations were developed by employees across the County and have resulted in \$1.1 million in ongoing savings and a number of operational efficiencies.

County Workforce

Placer County continues to have a strong and committed workforce dedicated to meeting the County's obligations and the expectations of the public. The number of allocated positions has declined slightly over the past three years from 2,768 positions in FY 2008-09 to 2,754 positions in FY 2010-11. However, due to the hiring freeze, the number of filled positions has declined by 13 percent from 2,542 in FY 2008-09 to 2,222 in FY 2010-11. At the same time, the County's population has continued to trickle up resulting in the per capita number of employees decreasing from 8 employees per 1,000 County population to 6.5 employees per 1,000 County population.

The three year staffing trends by functional area are included below:

Functional Areas	FY 2008-09	FY 2010-11	Percent Change
HHS	843	672	20% decrease
Land Use	585	484	17% decrease
General Government*	347	295	15% decrease
Finance	143	130	9% decrease
Public Safety	687	641	7% decrease

*Includes: Library, Clerk-Recorder, Board of Supervisors, County Executive Office, Administrative Services, County Counsel, and Personnel.

The growing gap between allocated and filled positions will be evaluated as part of the FY 2011-12 budget development. Recommendations to address the gap may be brought back to the Board following analysis of all the Departments submitted Base Budgets and further clarity about potential Federal and State impacts.

FY 2010-11 Check-in

At the mid-year point, the FY 2010-11 Budget is generally tracking with expectations as General Fund revenues and expenditures are approximately the same percentage of budget year-to-date as in the prior two years. Revenues, however, do remain volatile and are below the amount received in the last few years, in part a reflection of State reductions as well as the State's continue delay in making payments. On the whole, revenues are budgeted much closer to the margin than has been the case in years past. To address this, expenditure savings, primarily a product of salary savings, will provide the necessary flexibility to respond to revenue fluctuations for the current year. It is the proactive and decision Board actions outlined above that have restricted expenditures where necessary in light of the existing revenue climate. This will result in a fund balance to assist in offsetting cost pressures in FY 2011-12.

FY 2011-12

The starting point for FY 2011-12 includes a \$7.5 million combined deficit in the General and Public Safety Funds absent any mitigations consistent with the December 14, 2010 Board update. Of that amount, the General Fund contains a \$4.7 million deficit and the Public Safety Fund contains a \$2.8 million deficit. The deficit is primarily the result of an additional projected five percent decline in Property Tax revenue, the County's largest fund source, the loss of one-time funding, and ongoing cost drivers such as health insurance premiums and increasing PERS costs due to lower investment returns. The amounts also reflect the assumption of no longer using General Fund reserves. Since FY 2008-09, General Fund reserves have been reduced from \$18 million to \$8.2 million as part of the Board's smoothing approach to weathering the storm.

Initial Solutions

To resolve the deficit, a number of solutions have been assumed including the following:

- Continue existing labor adjustments related to increased employee health care and retirement cost sharing.
- One-time adjustments related to decreased costs for Employee Group Insurance, retiree health and dental.
- Phased use of Internal Service Fund reserves to smooth cost increases over four years.

Departments have just submitted their initial Base Budgets and staff will be analyzing them and working through opportunities and challenges with Departments over the coming weeks. In putting their budgets together, Departments were requested to absorb a number of cost increases, including the following:

- Increased PERS contribution.
- Increased benefit costs.
- Loss of one-time revenues.
- Salary costs due to merit increases.

Some Departments will likely face service and/or operational impacts to meet their Base Budget target. Staff will update the estimated deficit amount once all Department budgets have been vetted to provide clarity of available resources (i.e. Federal, State, and grant revenues) and potential impacts. With the adjustments, and absorbed cost increases, the adjusted deficit is now estimated at \$2.8 million in the General Fund and is tentatively balanced for the Public Safety Fund.

The Board will be updated as the Proposed Budget is pulled together and presented for your consideration and further direction. The gorilla in the room will remain the State's proposed Realignment of services which could have a far reaching impact not known until the Summer.

The FY 2011-12 Budget requires careful planning and difficult decisions but can be resolved by continuing the Board's forward-thinking approach to sustainable service and funding levels. Absent significant State impacts, the Placer County budget deficit is resolvable.

Proposed State Budget Impacts

\$30 million in direct county funding could be impacted. Impacts span county services but primarily focus on the following areas:

Redevelopment – The Governor's Budget proposes to eliminate redevelopment agencies, rake-off \$1.7 billion in unencumbered local funds for one-year, and implement a new approach to economic development at the local level.

Realignment – The Governor's Budget would "realign" \$10 billion in Public Safety, Fire, and Health and Human Services programs over four years. The proposed Realignment would occur in two phases, with the first to be implemented in FY 2011-12 and the second to be implemented in FY 2014-15. Funding is primarily proposed to come by extending existing tax increases for five years beginning July 1, 2011.

Reductions/Cash Flow – The Governor's Budget would reduce funding to a number of existing County responsibilities including Libraries, Williamson Act, Public Safety, and Health and Human Services. In addition, State payment deferrals of \$8.5 million will strain local cash flow.

The State Senate and Assembly are in the process of finalizing their initial respective budget proposals and are scheduled to begin reconciliation of the differences as early as next week. At this point, there remains a long way to go to have a viable budget deal worked out by the Governor's declared mid-March deadline. That deadline is needed to allow sufficient time for any proposals requiring voter approval at the tentatively scheduled June 2011 Special Election.

Local Challenge Areas

There are a number of challenge areas that warrant targeted focus and planning. These challenges will be discussed in detail through a series of Board workshops and primarily comprise the following areas:

Health and Human Services – The proposed Realignment of mandated Health and Human Services programs such as Child Welfare Services, Adult Protective Services, Mental Health, and Substance Abuse Treatment could significantly impact local funding

and operations. In addition, implementation of Federal Health Care Reform has substantial implications as well as opportunities in how the County meets its obligations.

Library – The proposed elimination of all State support for libraries could significantly impact local Library funding and operations. This is compounded by the third consecutive year of dedicated property tax revenue declines.

Public Safety – The proposed Realignment of Public Safety funding and services such as Low Level Offender responsibilities, Adult Parole, Juvenile Probation, and Court Security could require substantial changes to existing operations. Other areas of focus include the South Placer jail, and impacts due to State law changes such as Jessica's Law and Marcy's Law.

Fire Protection – Dedicated property tax revenue declines for three consecutive years have strained the fiscal resources available for independent Fire Districts within the County fire protection system. These challenges may be exacerbated by the State's proposed Realignment of fire services which could shift additional responsibilities to local Fire Districts.

Public Works – Road Fund declines have created implications for current and future project planning. In addition, State proposals to defer payments will create cash flow challenges for funded projects.

FY 2012-13 and beyond

The Federal/State/Local economic recovery is projected to occur at a sluggish pace over the next couple of years. Property values may remain stagnant or decline for another year or two while sales tax has begun to show some initial signs of tentative improvement. As a result, revenues will continue to struggle with deficits projected over the next few years. Due to historical and continued proactive and fiscally sound Board actions, locally projected deficits, although certainly challenging, can be solved. Local risk areas will continue to some degree but the County's largest potential exposure will continue to be linked to Federal and/or State impacts.

Next Steps

- FY 2011-12 Budget Development
- March/April BOS Budget Workshops
- May/June FY 2011-12 Proposed Budget
- August FY 2011-12 Budget Workshops
- September FY 2011-12 Final Budget